HOUSE BUDGET COMMITTEE

Democratic Caucus

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SUMMARY AND ANALYSIS OF PRESIDENT BUSH'S APRIL BUDGET

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Ranking Member

This document has not been reviewed and approved by the Democratic Caucus of the Budget Committee and may not necessarily reflect the views of all members.

General Notes:

- ! All years are fiscal years unless otherwise noted.

- ! Throughout the document, the Congressional Budget Office is abbreviated to CBO. The Office of Management and Budget is abbreviated to OMB.

- ! Unless otherwise noted, funding levels for discretionary programs are stated in budget authority, and funding levels for entitlements and other direct spending programs represent outlays.

- ! Figures in the President's budget are OMB estimates. Unless otherwise noted, estimates used for mandatory comparisons are OMB estimates. However, comparisons with the 2001 level of funding for discretionary programs are comparisons with CBO's baseline estimate of what is needed to maintain purchasing power at the 2001 level, and not with the actual 2001 appropriated level (known as the "2001 freeze level").

- ! Numbers may not add due to rounding.

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Overview

President Bush's budget suffers from tunnel vision. It fails to see multiple risks that could easily cause disastrous results. It plows toward its overriding objective — an outsized tax cut — almost mindless of the potential consequences.

The Bush budget documents contain greater detail, but no global changes from February's *Blueprint for New Beginnings*. But since the *Blueprint* was released, circumstances have worsened, confirming concerns we raised two months ago. Meanwhile, in the Senate, the President's tax cuts were voted down by $400 billion and spending initiatives were voted up by $600 billion, changing radically, if not rejecting, major parts of his budget.

As in February, Democrats express two key concerns*:*

- First, to have his tax cut, the President's budget has to dissipate virtually all of the non-Social Security, non-Medicare surplus over the ten-year budget period. The budget leaves almost no margin for contingencies and sets in motion a large tax cut before even estimating, much less deciding, how much is required for the largest account, national defense. Even assuming no further increases in defense or agriculture, the budget still invades the Medicare surplus in 2005 and 2006, weakening Social Security and Medicare just as the baby boomers are about to retire.

- Second, to make room for the tax cut, the Administration confronts the Congress with a budgetary dilemma. We must either overspend the available surplus, risking the economy and the long-term solvency of Social Security and Medicare; or we must accept harmful cuts in programs that we and the people support. The new budget makes this dilemma even more troubling than it seemed in February; for unlike February's *Blueprint*, the full budget details key cuts in important programs. The function sections of this document give a detailed discussion of these cuts. Here are a few of the most notable and disturbing:

  – A cut in funds for training pediatricians in children's hospitals.

  – A deep cut in funds for educating physicians, nurses, and health care professionals.

  – A freeze in grants for the treatment of AIDS patients.

  – A freeze in funds to locate physicians in medically under-served parts of the country.

– A cut in funding for the Centers for Disease Control.

– A cut in the Clean Water State Revolving Fund, which makes low-interest loans to modernize water and wastewater treatment systems.

– A cut in funding for monitoring toxic substances in ground and surface water.

– Elimination of the Wetland Reserve Fund, which provides voluntary incentives for conservation by farmers.

– A cut in scientific research on clean air and pollution.

– A $435 million cut in funds for cleaning up nuclear and hazardous waste at nuclear weapons plants.

– A $117 cut in funds in Nunn-Lugar, the key program for impeding the spread of nuclear weapons.

– A cut in funds for training and employment services, and a freeze in participation in the WIC program, just it appears that unemployment could rise.

– A cut in the Child Care and Development Block Grant, which has helped recent welfare recipients to go to work.

– Cuts in funds that states use to provide welfare, child care, and welfare-to-work assistance.

– Elimination of funding for rental vouchers for disabled persons displaced from public housing designated for the elderly.

– A cut in funds for critical building repairs in public housing.

– Termination of the Public Housing Drug Elimination Program.

– Termination of a program to create Boys and Girls Clubs in public housing.

– A 46% cut in funding of the COPS program.

The remainder of this overview explains how the budget threatens Social Security and Medicare, and imposes risks to the economy. The following sections pinpoint the cuts and programmatic choices made by the budget.

The Bush Framework

President Bush first proposed his $1.6 trillion tax cut on December 1, 1999. In his February 27, 2001 address to the Congress, the President explained the size of his tax cut this way:

> I didn't throw darts at the board to come up with a number for tax relief. I didn't take a poll or develop an arbitrary formula that might sound good. I looked at problems in the Tax Code and calculated the cost to fix them.

In hindsight, this explanation seems curious, given the President's statements later that Congress was free to alter his plan in many ways, so long as it adhered to the $1.6 trillion total. But in any event, the central fact is clear: The President's $1.6 trillion tax cut came first, and the rest of the budget was built around it.

Such a method could lead to the discovery that the rest of the budget did not fit, and could not accommodate basic needs. A budget built this way could over-commit or leave out important needs. Policymakers have to be wary of this possibility, and be prepared to reconsider the single-minded commitment to anything, whether a large tax cut or a large spending initiative. The Bush Administration shows no such concern. A $1.6 trillion tax cut is their overriding objective, and this explains the many gimmicks and insupportable cuts in their budget.

The Contingency Fund

Like the President's *Blueprint*, the President's budget purports to have a buffer against adverse developments. It claims a substantial "contingency reserve." But as one moves through the Bush budget, the contingency fund changes size at least three times. On Page 3, the President's message claims "an unprecedented $1 trillion reserve." On page 7, the budget raises the claim to "an unprecedented $1.4 trillion reserve." On page 223, in the numerical tables, the budget drops to $841 billion available for "contingencies." But examine the $841 billion fund, and you will find that it includes $525 billion from the surplus in the Medicare trust fund. In truth, the contingency fund is $318 billion spread over ten years, and most of this accumulates in the second five years. These are not mere discrepancies. They are built in by design to conceal just how thin the margin for error and the fund for contingencies actually are.

Table 1 below uses the budget's own figures to show how the President's new budget framework arrives at each of these four figures. The fourth variation simply observes the terms of the Medicare lockbox bill, H.R. 2, which passed the House by 407 to 2 on February 13. Version 1 shows that the budget can claim a $1.4 trillion contingency reserve only by ignoring its own proposal for a Medicare prescription drug benefit, and the impact of its initiatives on the government's debt service costs.[1] Version 2 shows that the claim of a $1.0 trillion contingency reserve omits the prescription drug proposal. It challenges logic and accounting to say that funds to pay for one of the budget's key proposals are also available for contingencies. Version 3 uses the framework listed at another location in the budget, to show the contingency reserve at $841 billion; but as noted above, this includes the surplus accumulating in the Medicare HI Trust Fund.

Table 1: ALTERNATIVE FORMULATIONS OF THE PRESIDENT'S "CONTINGENCY RESERVE"

(Billions of dollars over 2002-2011)

	Version 1	Version 2	Version 3	Version 4
Unified Surplus	5,637	5,637	5,637	5,637
Less:				
Social Security Surplus	2,591	2,591	2,591	2,591
Medicare Surplus	Ignored	Ignored	Ignored	525
Tax Cut	1,612	1,612	1,612	1,612
Prescription Drug Coverage	Ignored	Ignored	153	153
Spending Increases	19	19	19	19
Resulting Debt Service	Ignored	420	420	420
Equals:				
"Contingency Reserve"	**1,415**	**995**	**841**	**318**

Items may not add to totals due to rounding, and to fluctuations in the annual surplus or deficit of the United States Postal Service.
Source: Budget, table S-1, page 223; "A Blueprint for New Beginnings," table III-1, page 14.

None of the reserve fund formulations in the budget complies with the near-unanimous decision of Congress in H.R. 2 to set aside not only the surplus for Social Security but also the surplus in the Medicare Hospital Insurance (Part A) trust fund.

Reserving the Social Security and Medicare Trust Fund surpluses has both accounting and economic significance. In accounting terms, these surpluses are encumbered already to meet future benefits to today's payroll taxpayers. In economic terms, protecting these surpluses adds

[1]The budget baseline assumes that all budget surpluses reduce debt, hence debt service costs rise when surpluses are used for another purpose. Any proposal that would divert the surplus from reducing debt by either cutting taxes or increasing spending must therefore increase debt service costs relative to that baseline.

to national saving, which increases capital formation and productivity, helping us afford those benefits when they come due. Every argument for preservation of the Social Security surplus, which is accepted on all sides including the Administration, applies with equal force to the Medicare surplus.

Therefore, the contingency fund should omit both Trust Fund surpluses. Version 4 in Table 1 above omits both, and shows a contingency fund of only $318 billion, not $841 billion. Thus, the apparent size of the Bush contingency fund is due to the assumption that the Medicare surplus is available money, contrary to the emphatic will of the Congress. Once the Medicare surplus is protected, the Bush budget's reserve funds almost vanish.

The Contingency Fund Year-By-Year

Even more revealing is the size of the Bush contingency reserve over time. Table 2 takes the President's program at face value, showing the contingency reserve, after setting aside the Medicare HI Trust Fund surplus as well as the Social Security surplus, on a year-by-year basis. The President's own numbers show that he would invade the trust fund surpluses in 2005 and 2006, and leave virtually no margin for error over the entire decade. The Congressional Budget Office recently estimated that its average deficit or surplus projection error ***for a fiscal year already in progress*** is about 0.5 percent of GDP (or a bit more than $55 billion at 2002 levels). The President's budget projects non-trust-fund surpluses with less than that minimal margin of confidence until 2011. (CBO has also stated that its estimating errors grow enormously as projection periods extend into the future. Its average error five years in the future is six times as large as the error for a fiscal year in progress.) The President's budget slices right to the bone over virtually the entire ten-year budget period, with almost no cushion in case of error. ***Of the President's $318 billion ten-year non-trust-fund contingency reserve, less than nine percent is projected to occur in the first five years***.

Uncertainty in CBO Projections

From *The Budget and Economic Outlook: Fiscal Years 2002-2011*, January 2001

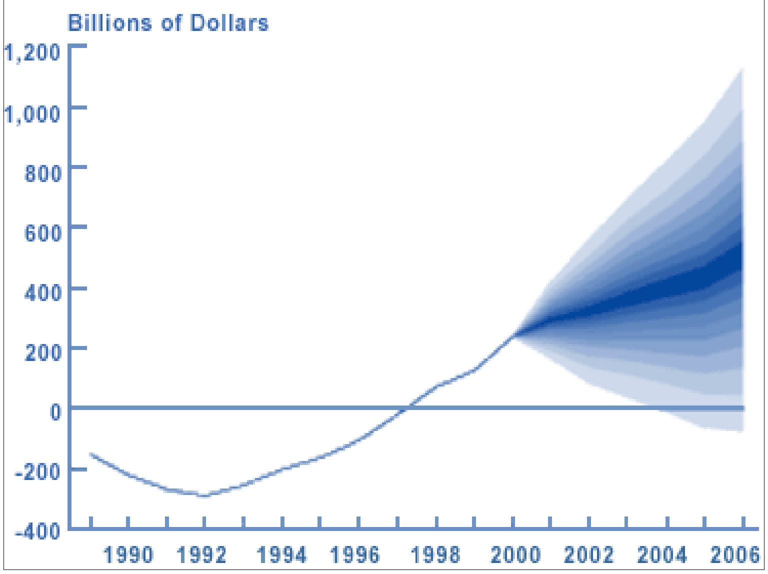


Table 2: BUSH BUDGET FRAMEWORK AND CONTINGENCY RESERVE (Billions of dollars)	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2002-11
Baseline Unified Surplus	**284**	**283**	**334**	**387**	**439**	**515**	**585**	**651**	**725**	**814**	**903**	**5,637**
Social Security	156	172	193	211	237	252	270	287	303	323	343	2,591
Medicare Part A	29	34	39	44	47	54	56	59	61	65	66	525
Available Surplus	99	77	101	133	156	209	259	305	361	425	495	2,520
Bush Tax Cut	0	29	66	99	132	169	193	208	221	243	251	1,612
Bush Spending Increases	3	21	20	14	19	13	13	16	15	20	22	172
Resulting Net Interest	0	2	6	12	20	29	40	54	69	86	104	420
"Contingency Reserve"	**95**	**26**	**10**	**8**	**-14**	**-1**	**13**	**27**	**56**	**76**	**118**	**318**

Items do not add to totals due to rounding, and to fluctuations in the annual surplus or deficit of the United States Postal Service.

Obviously, this approach to the budget leaves the contingency reserve itself, and the economy, vulnerable to a host of risks. With no significant reserve for at least the first nine years, ***any*** use of the contingency reserve, for whatever reason, would drive the budget into the red.

So what are the risks that the Bush budget creates?

The Bush Budget's Risks for the Economy

The federal budget at the end of 2000 was stronger than it had been in half a century. Fiscal policy was in a virtuous circle. Good fiscal policy was supporting a strong economy, and a strong economy was supporting good fiscal results. The President's proposals put that process at risk.

Omitted Costs

The Bush budget ignores risks to the budget and the economy in part because it omits inevitable costs from its calculation, and overstates its "contingency reserve," while understating the risk that the budget will revert to deficit in the near future.

A prime example of major costs omitted from the budget is defense. The Administration has claimed with some pride that it has not presented a defense request for future years because it has not yet completed "a top-to-bottom review" of the nation's needs. Although this degree of care may be admirable, one can only wonder why the same care should not have been shown for the budget as a whole. Instead, the Administration guessed how much of a ten-year commitment to tax cuts it could make, and now it would lock that guess into law, without knowing how much more spending defense might impose on the budget.

Table 3: THE BUSH CONTINGENCY RESERVE IS ALREADY OVER-COMMITTED
(Billions of Dollars Over 2002-2011)

Unified Surplus	5,637
LESS	
Social Security Surplus	2,591
Medicare Surplus	525
EQUALS	
Available Surplus	**2,520**
LESS	
Tax Cut	1,612
Prescription Drug Coverage	153
Spending Increases	19
Resulting Debt Service	420
EQUALS	
Bush "Contingency Reserve" (Excluding Medicare Surplus)	**318**
LESS OMITTED COSTS	
Defense – Add One-Percent Growth	195
AMT Fix, Tax Extenders, Other Tax Cuts	300
Senate Medicare Drug Increase	147
Senate Other Health Increase	50
Senate Education Increase	294
House / Senate Veterans Increase / Savings Reduction	31
Senate Agriculture Increase	59
Senate Energy / Environment Increase / Savings Reduction	8
Further Debt Service	271
EQUALS	
Remaining "Contingency Reserve"	**Negative**

Items do not add to totals due to rounding.

No one knows precisely what the Administration's defense review will conclude, but there is no doubt it will conclude that more money, not less, is needed. For example, the budget includes no estimate of how much the President's missile defense initiatives will cost, but estimates indicate that the cost could easily run into tens of billions of dollars. If the President upheld a campaign goal of increasing defense to 3.1 percent of GNP, it would cost $650 billion over ten years. Just increasing growth in defense spending by one percent per year would add $195 billion to budget costs over ten years. Table 3 puts potential defense costs into the context of the Bush Administration's meager reserves. (See Function 050 (National Defense) for further discussion of the defense budget.)

Defense is not the only example of omitted costs in this budget. The Administration's proposed tax cuts would worsen the existing problem of a widening individual alternative minimum tax (AMT). Over the coming years, increasing numbers of middle-income taxpayers will become subject to the AMT in large part because its basic income exclusions are not indexed for inflation. The AMT is burdensome not only because it imposes a higher tax liability than does the ordinary tax law, but also because it requires that individuals compute their taxes a second time according to a different set of rules. Over the next ten years with the Bush tax cuts, an additional 15 million taxpayers would be subject to the AMT, and would pay $292 billion in AMT. Unfortunately, the Administration does not propose to address this consequence of its tax cuts. Regardless of whether the Administration accepts responsibility for correction of the additional AMT problems its tax cut package will impose, virtually every authority believes that such a correction is inevitable. Including the revenues lost to an AMT correction does no more than recognize that reality.

Senate and House Conflicts with Bush Budget

To fit its predetermined $1.6 trillion tax cut within the available resources, the Administration chose a long list of spending cuts and minimized the projected costs of its spending-side initiatives. However, in the time between the release of the February Blueprint and the April budget, the Senate and the House have already rejected many of these savings, mainly because they are bad policy that would never have been called upon except to make room for the tax cuts. These Senate and House actions impose additional costs that are omitted from the Bush budget framework.

Table 4 enumerates some of the actions and omissions in the House and Senate budget resolutions and show how far Republicans in the Congress are from the President, and how much pressure those additional costs put on the budget.

Table 4: HOUSE AND SENATE POLICY DIFFERENCES WITH BUSH BUDGET
(Billions of dollars over 2002-2011)

Medicaid Upper-Payment Limit	Savings omitted by House	17
ANWR Oil Royalties	Savings omitted by House and Senate	1
Veterans Benefit Savings	Savings omitted by House	1
Veterans Benefit Additions	Spending added by House or Senate	30
Education	Spending added by Senate	224
Education for the Disabled	Spending added by Senate	70
Medicare Prescription Drug Coverage	Spending added by Senate	147
Agriculture	Spending added by Senate	59
Home Health	Spending added by Senate	14
Defense	Spending added by Senate	7
Other Health	Spending added by Senate	36
Environment	Spending added by Senate	7
TOTAL		**613**

This table shows a long list of instances where the Republican-controlled Congress does not see eye-to-eye with the President. The table also shows that a substantial amount of the budget cuts that the President counted on to make room for his tax cut are not acceptable to Congress. The Senate chose to reduce the size of the tax cut by more than $400 billion, or almost one-fourth, to accommodate a part of these increases in spending, and so their actions did not detract dollar-for-dollar from the budget surplus. But that merely reinforces the point that the President's budget framework and his large tax cut are not acceptable at face value even to members of his own party, and when faced with an explicit choice, a Republican-controlled Senate voted to reduce the tax cut.

These actions by Congress include rejection of some of the President's proposed savings and additions of spending for prescription drug coverage under Medicare, education, and agriculture. Had the President's full budget been available, there probably would have been even more movement by the House and Senate. Outside Congress, with the arrival of the President's budget documents, there is a growing reaction against his spending cuts now that they are revealed in detail. Examples were suggested at the beginning of this overview; more will follow in the section on individual budget functions.

In a sense, important parts of the President's April budget were "dead before arrival." Democrats argued in February that the President's *Blueprint* did not have sufficient data on the spending cuts needed to accommodate the President's tax cut, but Republicans insisted on proceeding with the budget process without them. The outcome of the process has demonstrated our point. The President's spending reductions appear to be more than Congress will tolerate, and his spending initiatives, particularly for education and prescription drug coverage, are less than Congress deems needed. The amounts of the additional spending and reduced spending cuts are thus shown in Table 3 as further omitted costs.

Table 3 should not be taken to assert that the Congress will immediately and blindly overspend the budget surplus (though the 1981 experience should give us pause). However, table 3 does indicate that writing the oversized tax cut in stone first was the wrong way to proceed. More important national priorities, including fiscal responsibility, cannot coexist with a tax cut of this size. Even if the economic and budget projections prove accurate, sooner or later the Congress will reach a choice between breaking its hasty tax-cut promise and ignoring serious national needs.

Economic Risks

There are further risks in the President's budget. For example, the economy does not always perform on cue. And in recent years, non-economic estimating errors — so-called "technical re-estimates" — have been even larger than economic errors. Over the last eight years, budget projection errors have been large, but almost always in a favorable direction. During the preceding twelve years, projection errors were equally large relative to the budget, and almost always in an unfavorable direction. It seems only prudent to leave a margin of safety so that any economic misfortune in the future or any errors in projections will not leave the budget in an untenable position. Unfortunately, this is not the course the President chose to follow. His contingency or reserve fund is less than CBO's most minimal measure of estimating errors.

Estimating Uncertainty

The President is proposing highly significant changes in policy. It is always difficult to estimate how large policy changes will affect budget outcomes. This was true in 1981 when budget outcomes were far worse than the Reagan White House (or CBO) ever expected; and it was also true in 1993 when the economy and the budget responded to the deficit reduction far better than even its staunchest advocates had hoped. Budget estimation practices may be getting better, but uncertainty is still considerable. In recent weeks, non-partisan congressional tax staff have discovered that repeal of the estate tax would open doors to wholesale reduction of individual income tax liabilities within wealthy families. As a result, estimates of the revenue cost of the President's estate tax proposal have soared. Republicans on the Ways & Means Committee have had to postpone repeal outside the ten-year budget window entirely. (Repeal would take place in the tenth year, but given the time allowed to file estate tax returns, virtually no direct effect appears in the budget estimates.) Similar increases in the estimated costs of the President's proposed income tax cuts should likewise give pause to those who care about fiscal responsibility.

Effects Beyond the Ten-year Budget Window

The Bush tax cut is heavily back-loaded. As a result, the ten-year cost understates revenue consequences in later years. Although estimates of policy effects more than a decade off are far from precise, there must be concern that the effects of a large tax cut could cascade over time, and become apparent only after the tax cut is fully phased in and thus is hardest to adjust.

The Aging of the Baby Boom

The most alarming signal on our budget radar is the impending retirement of the baby boomers. The President's tax cuts would phase in fully just as the baby boomers phase out of the labor force. The first of the baby boomers, born in 1946, become eligible for reduced Social Security benefits, at age 62, in 2008. With the non-trust fund surplus in the President's budget at virtually zero through 2010, any adversities in the economy, any estimating errors, or any other budgetary problems would leave policymakers little margin for error and no time to maneuver.

Conclusion

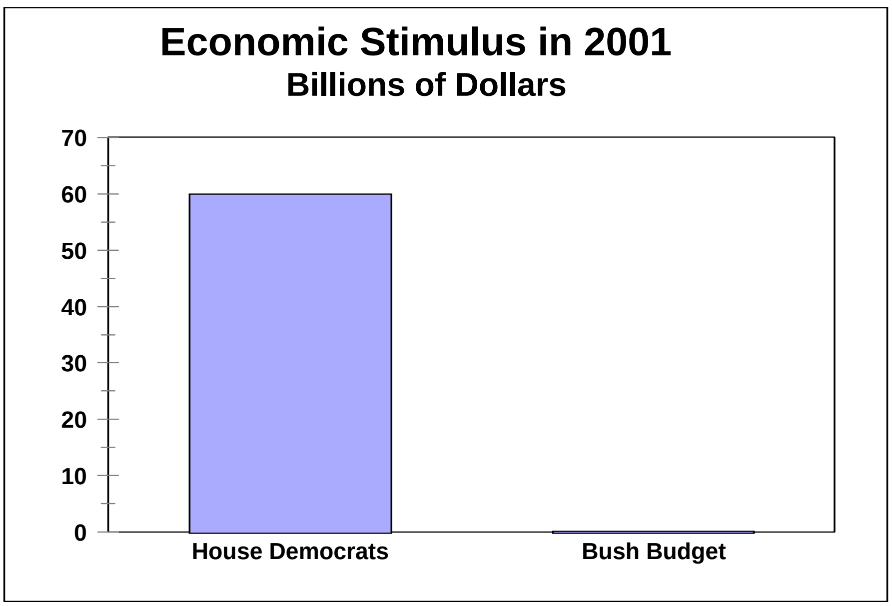
The history of the budget over the past few decades is full of surprises and major misjudgments that have been hard to reverse and painful to correct. The future is full of demographic changes for which there is no history or experience to follow. Judgment and common sense call for caution and restraint. Instead, the President presents us a budget that leaves little margin for error and nothing for our long-term liabilities.

The budget is at its strongest in a half century. On its current track, the nation can retire all of the debt held by the public for the first time since 1835, and add three trillion dollars to net national savings. Alternatively, we can replay the dramas of the Eighties and early Nineties, and risk a return of the days when the national debt grew faster than the national income. The choice would seem clear; but it was not to those who wrote the Bush budget.

The Bush Tax Cut

The Administration often claims the tax cuts in President Bush's budget are an afterthought, merely returning government "overcharges" to the taxpayers after funding basic needs and reducing public debt. In reality, tax cuts are the budget's overriding priority. House Republicans, with the President's encouragement, have pressed ahead with the largest elements of the tax package well before the Administration figured out its budget or the Congress had passed a budget resolution.

Congressional Republicans and the President have argued that the "sputtering" economy justified such haste in pushing a huge, multi-year tax cut. However, the numbers in the President's budget do not support this. The budget calls for a cut of only $172 million in 2001. This amounts to a mere 0.002 percent of GDP, a trivial stimulus. The President's tax package is extremely back-loaded even according to his own estimates, with almost 70 percent of the revenue loss in the second five years.



Unfortunately, the estimates of the tax cuts included in the President's budget understate their real cost. The budget claims that the total revenue loss of the President's many tax cut promises does not exceed $1.6 trillion over ten years. However, Congress's official scorekeeper, the Joint Committee on Taxation (JCT), has found that the largest elements of the package cost considerably more than claimed. There may be reason to believe that the remaining elements of the President's tax package that JCT has not scored are understated as well.

The True Cost of the Bush Tax Cut

The claim in the President's budget that the proposed tax cut "accounts for only one quarter of the projected ten-year budget surplus" is mistaken, even if one takes the tax cut's understated cost estimate of $1.6 trillion at face value. In fact, the President's own numbers show that the direct revenue loss from the tax cut amounts to 29 percent of the unified surplus. If one includes the added spending on interest payments to bondholders that the tax cut will require, the figure rises to 36 percent. As a percent of the surplus available outside of Social Security and Medicare, the tax cut with debt service consumes 75 percent of the surplus.

If one uses more realistic estimates of the tax package's cost, the tax cut and associated debt service would appear to exhaust almost all of the surplus outside of Social Security and Medicare. The table below shows the effect of (1) substituting JCT's estimates for the largest components of the Bush tax package for the Administration's estimates; (2) adjusting the tax cut to prevent it from forcing an intolerable number of middle-class taxpayers to pay the alternative minimum tax; and (3) accounting for the fact that the tax cut will require higher government spending for interest on the national debt.

JCT estimates of the two House bills, H.R. 3 and H.R. 8, that embody the President's rate cuts, the increase in the child credit, and marriage penalty relief were $241 billion higher than the Administration claimed. Because these two bills consume close to $1.4 trillion, House Republicans could not pass the President's proposal to repeal the estate tax without breaching the $1.6 trillion ceiling, given that the Administration estimates its cost at $262 billion over ten years and JCT estimated the cost of immediate repeal at $662 billion over ten years. Instead, House Republicans introduced H.R. 8, which JCT estimated to cost less than the Administration proposal. The bill's unusually low cost results from it having very little relief for the first nine years, with full repeal postponed until 2011. This pushes the true cost of repeal outside the ten-year budgeting window.

The Cost of Bush Tax Cut Promises—So Far

Billions of Dollars

Rate Cuts (H.R. 3)	958
Child Credit and Marriage Penalty (H.R. 6)	399
Estate Tax Repeal (H.R. 8)	193
Fix AMT Problems Caused By Bush Tax Cut	292
Charity-Related Tax Preferences	56
Permanent Extension of R&E Credit	50
Expand Education Savings Accounts	6
Health, Long-Term Care, and Miscellaneous Tax Cuts	123
Total Revenue Loss	**2,077**
Revenue Loss Plus Added Interest Payments to Bondholders	**2,560**

The table also shows the added cost of fixing the Bush tax cut's interactions with the alternative minimum tax (AMT). Under current law, the number of taxpayers subject to the AMT is projected to increase, but the Bush tax cut makes this problem much worse. If the Bush tax cut were passed as is, the number of filers subject to the AMT would rise to 36 million by 2011, including more than half of all families of four. Just to keep the Bush tax cut from increasing the number of filers subject to the AMT under current law adds $292 billion to the cost. That is, the President has promised taxpayers $292 billion in tax cuts that they will not get, and he will have to acknowledge this cost to keep his promise.

If one adds the Administration's estimates for the rest of its tax package to JCT's estimates of H.R. 3, 6, and 8, as well as the cost of fixing the AMT problems that the Bush tax cut creates, the total revenue loss from the Bush package exceeds $2 trillion. If JCT estimates for the charity-related, R&E, education, health insurance, and other proposals are also higher than the Administration's estimates, the revenue loss will be greater still.

In addition, the fact that the President's budget uses a substantial portion of the projected surplus for tax reduction rather than debt reduction means higher spending for interest payments to bondholders. This added debt service comes to almost half a trillion dollars and pushes the Bush tax cut's impact on the surplus up to almost $2.6 trillion. This comes close to exceeding CBO's estimate of the non-Social Security, non-Medicare surplus and more than exhausts the Administration's estimate of it.

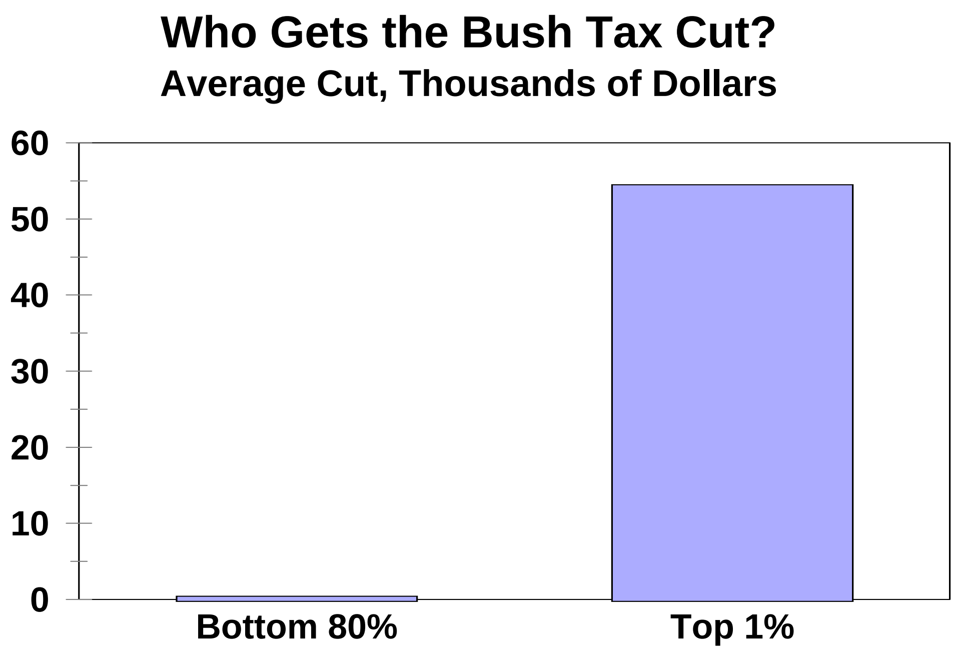
Finally, there are good reasons to suspect that the total cost of tax cuts this year could swell even more. First, the budget extends for only one year several popular expiring tax credits, like the work opportunity credit and the welfare-to-work credit. Congress has always renewed these credits in the past and certainly will in the future. Since these credits will unquestionably be renewed, as well they should, the budget should include an accurate accounting of their cost. This would add perhaps another $50 billion over ten years.

One might also worry about the ability to resist pressure to add new elements to the President's tax package that raise its overall cost. Members of Congress and the business community have already called for a variety of additional tax cuts. For instance, tax cuts passed by the House last year that do not overlap with the provisions of the Bush tax cut would add hundreds of billions of dollars to the cost over ten years. In addition, a broad consortium of industries has urged that various business tax cuts including a capital gains cut, accelerated depreciation, elimination of the corporate AMT, and lower corporate tax rates be enacted once the President's package of personal tax cuts has passed.

Tax Fairness

The President continues to downplay the lopsided nature of his tax cut. The President claims that his tax cut is fair because the percentage tax reductions in his plan are largest at the bottom of the income distribution. However, that amounts to saying that a restaurant worker whose $200 income tax liability is totally eliminated gets a larger benefit than a lawyer whose $20,000 tax liability is cut in half.

In fact, the highest income taxpayers would receive the greatest tax benefits from the Bush plan by any reasonable accounting. The share of the tax cut going to the top one percent of the income distribution exceeds the share going to the bottom 80 percent. Citizens for Tax Justice (CTJ) estimates that the top one percent, with incomes averaging more than $900,000 per year, will get an average tax cut of $54,480. CTJ estimates that the top one percent receives 45 percent of the tax cut's benefits even though they pay only 21 percent of federal taxes. By contrast, the bottom 80 percent gets 28 percent of the tax cut's benefits, with an average cut of $430.



The Administration has argued that the top one percent actually receive only 22 percent of the Bush tax cut. There are two problems with this calculation. First, the estimate is based on 2006, before many of the tax cuts that benefit the very affluent are fully phased-in. Second, the estimate does not include estate tax repeal, even though it accounts for 24 percent of the cost of the Bush tax cut when fully phased-in. Career staff at the Treasury Department have a model for calculating the distributional consequences of estate tax repeal, but the Administration declines to use it.

The Administration has defended the exclusion of estate tax repeal from its distributional calculations by arguing that decedents with large estates do not get the benefits of estate tax repeal, their heirs do. And, while we may know the income and wealth of the decedent, it is difficult to assess the economic status of the heirs.

However, Treasury data show, not surprisingly, that the children of decedents with large estates tend to have high incomes. A 1998 Treasury study showed that children receiving bequests in 1981 from estates valued between $2.5 million and $10.0 million had taxable incomes averaging $123,452, while those receiving bequests from estates over $10.0 million had average taxable incomes of $271,254. In 1981, these income levels were easily within the top five percent and top one percent, respectively. Since then, the price level has doubled, and real incomes have grown as well, especially at the top. We might thus infer that heirs of large estates today have incomes two or even three times as large as they were in 1981.

The President claims that "the typical family of four will be able to keep at least $1,600 more of their own money when the plan is fully effective." However, more than 85 percent of taxpayers will get tax cuts less than that amount, and many will get nothing. For instance, the Center on Budget and Policy Priorities (CBPP) estimates that one-third of families with children would receive no tax cut. CBPP estimates that more than half of all black and Hispanic families receive nothing from the Bush plan, even though three-fourths of these families include at least one worker.

The President's focus on a "typical family of four" also deflects attention from the fact that many people are not like this archetypal family. It is true that a married couple with two children and annual income of $50,000 would get a $1,600 tax cut, though only after 2005 when the plan is fully phased-in. However, a single mother with two children and a $22,000 annual income would get nothing. A retired widow with no children and an income of $30,000 would get a mere $300. By comparison, a couple making $550,000 with no children would get a $19,000 tax break.

The Bush budget seems designed as if the income tax were the only federal tax. In fact, three-quarters of all taxpayers pay more payroll taxes than income taxes, and the Bush budget does nothing to address this burden. This is because the Bush tax package makes no changes to the earned income tax credit (EITC), which was originally designed in part to offset the impact of payroll taxes on low-income workers.

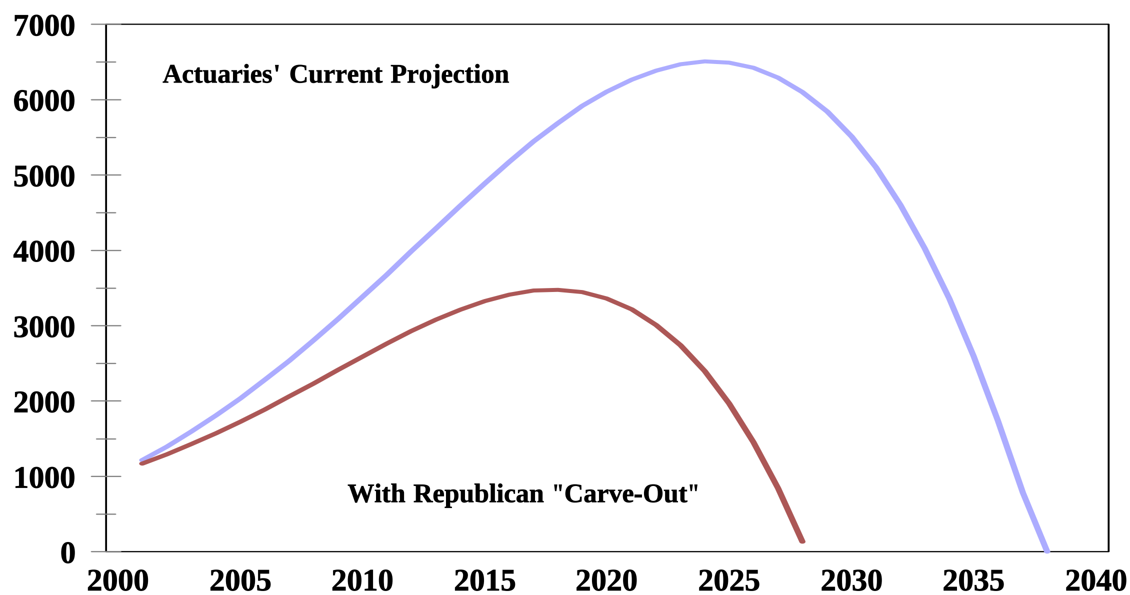
Jeopardizing the Future of Social Security and Medicare

The President's budget undermines the future of Medicare by diverting surpluses dedicated to paying benefits promised in existing law and using the money for new purposes. The budget also suggests that the President would do the same to Social Security. Over the next ten years, the President proposes to start diverting funds from the Medicare HI surplus, $153 billion over ten years, to create a new prescription drug benefit and finance undefined "reforms." His principles for "reform" of Social Security also imply that he would use the $600 billion of the Social Security surplus not devoted to debt reduction to institute private retirement accounts invested in the stock market.

Because the Social Security and Medicare surpluses are already committed to paying benefits promised in existing law, diverting money from the trust funds for new purposes can mean only one of two things. Either the budget double counts, or it shortens the solvency of the Social Security and Medicare HI Trust Funds, which eventually will force severe benefit cuts or tax increases. If one accepts that the same dollars cannot be used twice, then the only possible conclusion is that the budget gambles the future of the Social Security and Medicare Trust Funds.

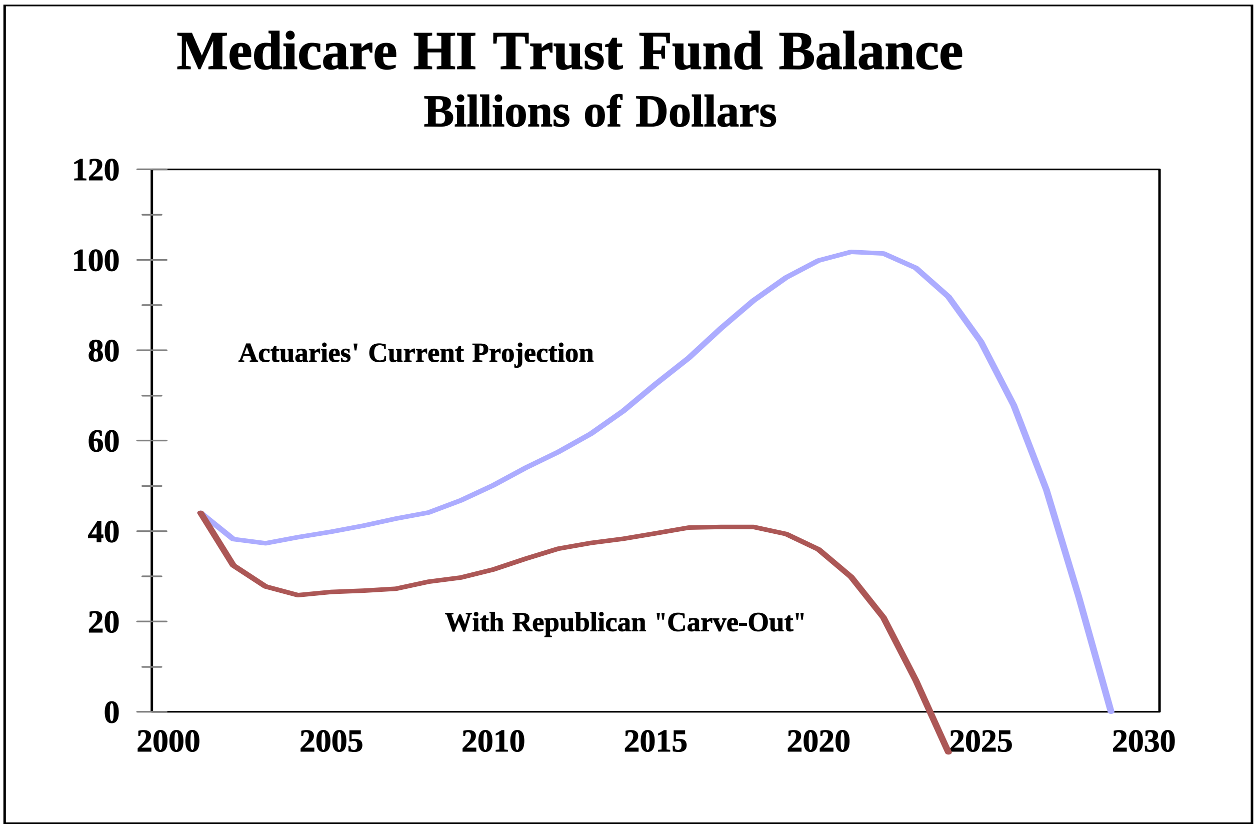
If Republicans follow through with a privatization proposal based on a "carve-out" of the Social Security surplus as the President advocated during the campaign, it will shorten the program's life. The chart below shows the impact on the Social Security Trust Fund if $600 billion over the

Social Security Trust Fund Balance
Billions of Dollars



next ten years is diverted for new stock market retirement accounts. The Social Security actuaries currently project that the trust fund will run dry 37 years from now, in 2038. Taking $600 billion away from the Social Security Trust Fund over the next ten years corresponds to a “carve-out” of 1.1 percentage points from payroll taxes. Such a “carve-out” shortens the solvency of the Social Security Trust Fund by nine years, bringing the date of insolvency back to 2029.

The chart below shows a similar effect on the Medicare HI Trust Fund from Republicans’ proposed diversion of $153 billion over ten years. Currently, the Medicare actuaries project that the HI Trust Fund will run dry in 2029. However, a “carve-out” that diverts $153 billion over ten years out of the Medicare HI Trust Fund shortens its solvency to 2024, five years sooner.



Because the Administration provides no specifics, it is not clear how the proposed “reforms” would work. However, it is clear that these “reforms” would somehow have to compensate for the effect that diverting resources from the trust funds has on the existing Social Security and Medicare benefits. It is conceivable, though perhaps unlikely, that stock market returns for individual retirement accounts or efficiency gains due to competition with private medical accounts might offset the severe benefit cuts from the existing programs that shortened solvency would require. However, the budget’s large tax cut undermines solvency because it consumes essentially all resources outside of the Social Security and Medicare surpluses that might be used instead to extend solvency.

By contrast, Democrats have consistently advocated putting more resources into Social Security and Medicare to extend, rather than shorten, the solvency of these two bedrock programs for the elderly. Social Security and Medicare are our most successful government programs, ensuring that millions of seniors live out their years in dignity. Democrats are reluctant to sacrifice the important protections these programs provide to fund unknown and untested innovations.

Appropriated Programs

Appropriated programs, also known as "discretionary" programs, are those controlled by the annual appropriations process. President Bush's budget provides $660.6 billion in budget authority for appropriated programs for 2002, which is $2.8 billion below the level needed, according to CBO, to maintain purchasing power for these programs at their 2001 levels.[1] However, as is explained below, the cut to domestic appropriations is much larger than the $2.8 billion overall cut.

The 2002 Appropriations Picture

Taking the Bush budget numbers at face value, the domestic portion of appropriated programs is cut $6.8 billion below the 2001 level. As Table 5 indicates, this occurs because the non-defense portion bears the entire burden of the $2.8 billion overall cut and then must be cut an additional $4.0 billion to accommodate the increase for defense and international affairs.

Table 5:
Comparing the President's Budget for 2002 Appropriated Programs to CBO's Estimate of Amounts Needed to Maintain Purchasing Power at 2001 Levels
(discretionary budget authority in billions)

	Bush Budget	CBO Estimate	Budget Above/Below CBO Estimate
Defense	325.1	321.7	+ 3.4
International	23.9	23.2	+ 0.7
Domestic	311.7	318.5	-6.8
Total Appropriations	660.6	663.4	-2.8

Numbers may not add due to rounding.

[1]The budget asserts that $660.7 billion is equal to the OMB estimate of the level needed to maintain purchasing power at the 2001 levels. However, domestic appropriations are cut using either CBO or OMB estimates of the 2001 level of purchasing power. The following analysis relies on CBO estimates because Congress traditionally uses these estimates rather than OMB's estimates during the appropriations process.

However, the level for appropriated programs includes an emergency reserve fund that totals approximately $62 billion over ten years, including $5.6 billion for 2002. See *The National Emergency Reserve* below for further discussion. This new fund is only to be tapped to provide funding to respond to major natural disasters such as earthquakes, hurricanes, and floods. There is no such reserve for 2001. To obtain an apples-to-apples comparison of the budget with 2001 levels of funding for ongoing programs, one should exclude the $5.6 billion fund from 2002 and those 2001 emergencies that do not represent ongoing programs but are rather true one-time-only costs.[2]

Table 6: A Domestic Appropriations Comparison
The Bush 2002 Budget vs. 2001 Freeze Level
(Discretionary Budget Authority in Billions)

	Bush Budget	2001 Freeze	Dollar Increase	Percent Increase
Gross Level	311.7	305.2	+6.2	2.1%
Less Emergencies	-5.6	-1.7	na	na
Adjusted Level	306.1	303.5	+2.6	0.9%

As Table 6 indicates, when an adjustment for emergency funding is made, domestic appropriations are actually only $2.6 billion (0.9 percent) more than the 2001 freeze level. This level for domestic appropriations is $10.9 billion (3.4 percent) less than the level needed, according to CBO, to maintain purchasing power at the 2001 level.[3]

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[2]Based on preliminary OMB data, the estimate of this amount is $1.7 billion for 2001.

[3]These levels exclude mandatory contract authority for transportation programs that result in discretionary outlays. If this contract authority is taken into account, domestic appropriations are only $5.1 billion (1.5 percent) more than the 2001 freeze level, but which is $9 billion less than the level needed to maintain 2001 purchasing power. In addition, the CBO estimate of the level needed to maintain purchasing power at the 2001 level (baseline) may overstate the budget authority needed in Function 600 due to the Housing Certificate Fund (HCF). CBO may make a technical adjustment to the HCF baseline in conjunction with its reestimate of the President's budget later this Spring.

The National Emergency Reserve

The President's budget establishes a "National Emergency Reserve" to cover the costs associated with natural disasters such as earthquakes, floods, and hurricanes. The budget includes $5.6 billion for this fund for 2002, and $61.9 billion over the ten year period (2002 - 2011). If natural disasters do not occur in any given year, or if the fund is not fully utilized, the fund may not be used for other purposes.

While sensible in concept, the budget is silent on what happens if costs associated with natural disasters exceed the funding in the reserve in a given year. The House Republican budget resolution, which is based on the Administration's proposal, implies that any excess for emergencies would have to be offset by other appropriated programs. If this is indeed the intent of the Administration's proposal, finding offsets to fund emergencies is not only poor public policy, but could greatly delay the emergency assistance.

The "Four Percent Increase is a Mirage"

The media widely reports that the President's budget increases appropriated programs by 4.0 percent. Unfortunately, these reports have created several widespread misperceptions about the President's budget.

First, while the 4.0 percent increase is true in nominal terms for overall appropriations (defense, international, and domestic programs), it is not true for domestic appropriations. In fact, as discussed above, the President's budget increases nominal budget authority for discretionary appropriations by less than one percent compared to the 2001 freeze level. Even if one does not adjust for emergencies, domestic appropriations only increase 2.1 percent.

Second, while inflation has been modest, it still exists and erodes the purchasing power of many programs. Families plan long-term budgets assuming college tuition costs or gasoline prices will increase, and the government must be cognizant of rising costs in its budgeting as well. Again, as explained above, when domestic programs are compared to the level needed, according to CBO, to maintain purchasing power at the 2001 level, the President's budget actually cuts funding for domestic programs by 3.4 percent.

Third, as is explained in *Winners and Losers in the President's Budget* below, the President's budget cuts the remaining domestic programs even further after taking into account the increases provided for the Health and Education and Training functions. Over the ten year period (2002 - 2011), the budget cuts these remaining domestic programs by a cumulative total of more than $150 billion.

Finally, there is a widespread misperception that the 4.0 percent increase continues over the course of the ten year budget proposal (2002 - 2011). This is incorrect. Even using the flawed methodology the Administration uses to calculate the 2002 increase, all appropriated programs only increase an average of 2.3 percent per year in nominal terms over the 2002 - 2011 period.

Table 7: Winners and Losers in the Bush Budget

Appropriated Programs in the President's Budget
vs. CBO Estimate of Maintaining 2001 Purchasing Power*
(discretionary budget authority in billions)

	Amount Budget is Over/Under 2001 Level of Purchasing Power		
Function	2002	2002-2006	2002-2011
National Defense	3.4	22.9	69.7
International Affairs	0.7	3.5	8.1
General Science, Space	-0.2	0.2	1.8
Energy	-0.5	-1.7	-1.1
Natural Resources and Environment	-2.6	-16.8	-44.6
Agriculture	-0.1	-0.3	-1.4
Commerce and Housing Credit	-2.8	-15.2	-23.3
Transportation	-2.1	-9.8	-23.7
Community and Regional Development	-1.3	-6.3	-13.9
Education and Training	1.0	9.2	24.8
Health	1.2	22.9	54.3
Medicare	-0.0	-0.8	-4.0
Income Security	-2.0	-6.2	-8.3
Social Security	-0.1	-0.8	-2.7
Veterans	0.0	-2.3	-11.6
Administration of Justice	-1.5	-5.7	-17.8
General Government	0.2	-1.1	-6.6
Subtotal, Domestic Appropriations**	-10.7	-34.5	-78.1
Subtotal, Domestic Except Health and Education and Training	-12.9	-66.5	-157.1

**Adjusted for appropriate emergencies.*
***The CBO baseline does not distribute the 0.22 percent across-the-board reduction contained in the 2001 appropriations. If this reduction were included, the total domestic appropriations reduction would be $32.2 billion over the 2002 - 2006 period and $73.1 billion over the 2002-2011 period.*
Note: Numbers may not add due to rounding.

Winners and Losers in the President's Budget

Table 7 compares the President's request to the levels needed, according to CBO, to maintain purchasing power at the 2001 level. Since the President establishes a new National Emergency Reserve, the CBO levels have been adjusted to exclude emergency funding that represents true one-time-only costs rather than ongoing programs for comparability purposes. In the table, positive numbers indicate increases, negative numbers indicate cuts.

As the table indicates, the budget cuts a total of $78.3 billion from domestic appropriations over the next ten years. However, as the table also indicates, two domestic functions, Education and Training and Health, are increased above the 2001 level by a cumulative total of $25 billion and $54 billion, respectively, over the ten year period (2002 - 2011). If these two functions are excluded, then the remaining domestic programs are cut by a cumulative total of more than $150 billion over the ten year period (2002 - 2011).[4] For 2002, the cut to remaining domestic program is $13 billion (6.2 percent) compared with the level needed to maintain purchasing power at the 2001 level.

New User Fees in the Budget

The budget includes a total of $2.3 billion in user fees over the 2002 - 2006 period to offset appropriated programs. In the past, Congressional Republicans charged that such user fees are "taxes"on the public, and criticized user fee proposals by the last Administration. It is therefore ironic to see the new Administration propose some of the same user fees. To the extent that Congress rejects these user fees, then the total funding for appropriated programs must either be increased to compensate for the loss of the funding generated by the user fees or appropriated programs must be cut.

The *Overview* section discusses some of the more notable specific cuts in the budget, as does a separate report, *Bush Budget: Sacrificing All Else to Tax Cuts*, which can be found on the House Budget Committee Democratic website: /www.house.gov/budget_democrats. In addition, there is a discussion of the President's cuts in each relevant function analysis within this report.

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[4]As the second footnote on Table 7 also explains, the CBO baseline does not distribute the 0.22 percent across-the-board reduction that was included in the 2001 appropriations to each individual function. Thus, the aggregate totals in Table 7 are somewhat overstated. The total domestic appropriations reduction is $32.2 billion over the 2002 - 2006 period and $73.1 billion over the 2002 - 2011 period including the effect of the across-the-board reduction. Likewise, the remaining domestic appropriation cut is somewhat overstated, but a precise figure cannot be determined since the across-the-board reduction for the Health and Education and Training functions cannot be specified.

Table 8: Bush's February Blueprint vs April Budget
Changes in Appropriated Programs
(In billions of dollars)

	2002	2003	First 5	Second 5	10 Yr. Total
Total Discretionary					
Budget Authority	0.0	6.5	16.2	-18.1	-1.9
Outlays	0.0	3.4	13.3	-15.9	-2.6
Non-defense discretionary					
Budget Authority	-0.1	6.0	14.5	-18.6	-4.0
Outlays	-0.2	3.1	12.1	-16.3	-4.2
050 National Defense					
Budget authority	0.1	0.5	1.6	0.5	2.1
Outlays	0.2	0.3	1.2	0.4	1.6
150 International Affairs					
Budget authority	0.0	0.5	1.3	-0.8	0.5
Outlays	0.0	0.3	1.2	-0.3	0.9
250 General Science, Space					
Budget authority	-1.1	-0.6	-3.7	-5.4	-9.1
Outlays	-0.4	-0.7	-3.0	-5.0	-8.1
270 Energy					
Budget authority	-0.0	0.1	0.5	-0.2	0.3
Outlays	0.0	0.0	0.5	0.0	0.5
300 Natural Resources and Environment					
Budget authority	-0.0	0.6	1.2	-1.5	-0.3
Outlays	-0.3	0.2	0.5	-1.2	-0.7
350 Agriculture					
Budget authority	-0.0	0.0	-0.1	-0.6	-0.7
Outlays	-0.0	0.0	-0.1	-0.6	-0.6
370 Commerce and Housing Credit					
Budget authority	0.0	0.2	0.6	0.5	1.0
Outlays	0.0	0.1	0.5	0.5	1.0
400 Transportation					
Budget authority	0.9	1.5	6.3	5.6	11.9
Outlays	0.3	1.2	4.5	0.8	5.3
450 Community and Regional Development					
Budget authority	0.1	0.3	1.1	-0.9	0.2
Outlays	0.3	0.2	1.2	-0.3	0.9
500 Education and Training					
Budget authority	0.0	1.5	4.9	-1.5	3.4
Outlays	0.4	1.1	5.5	0.1	5.6
550 Health					
Budget authority	0.0	0.2	-0.9	-6.1	-6.9
Outlays	-0.1	-0.5	-1.8	-4.9	-6.7
570 Medicare					
Budget authority	0.0	0.1	0.3	0.1	0.4
Outlays	0.1	0.2	0.7	0.5	1.1
600 Income Security					
Budget authority	-0.0	0.6	1.5	-0.5	1.1
Outlays	-0.0	0.3	1.1	-0.2	0.9
650 Social Security					
Budget authority	0.0	0.1	0.2	-0.1	0.1
Outlays	0.0	0.1	0.2	-0.1	0.1
700 Veterans					
Budget authority	0.0	0.5	1.4	-0.8	0.5
Outlays	-0.0	0.5	1.3	-0.7	0.6
750 Administration of Justice					
Budget authority	0.1	0.4	1.9	-0.5	1.4
Outlays	-0.0	0.3	1.7	-0.2	1.5
800 General Government					
Budget authority	-0.1	0.3	0.6	-0.7	-0.1
Outlays	-0.2	0.1	0.4	-0.6	-0.2
920 Allowances					
Budget authority	-0.1	-0.3	-2.6	-5.1	-7.7
Outlays	-0.3	-0.4	-2.3	-4.0	-6.3

Changes from the February Budget Blueprint

The President's revised April budget for appropriated programs does differ from the February Budget Blueprint the President submitted to Congress. Table 8 displays the changes for appropriated programs for 2002, 2003, the five year total of the changes from 2002 - 2006, and the ten year total of the changes from 2002 - 2011. Positive numbers indicate increases from the February Blueprint, while negative numbers indicate decreases from the Blueprint.

As Table 8 indicates, the major changes for 2002 are in Functions 250 (General Science, Space, and Technology) and 400 (Transportation). These changes primarily correct an error contained in the February blueprint. After 2002, most functions receive increases over the 2003 - 2006 period and decreases over the 2007 - 2011 period. In total over the ten years (2002 - 2011), defense and non-defense appropriations have been revised slightly downward.

A letter from OMB states that these changes are not supposed to reflect policy changes, but rather are technical changes related to re-estimates of the President's policies. While this may be true, the fact is that the President's budget now has more funding for many appropriated programs in the near term relative to the February Blueprint, and less funding for many programs over the 2007 - 2011 period.

Conclusion

The level of appropriations in the Bush budget is unrealistically low. Even the Republican Chairman of the Senate Budget Committee said that "Some functions of government just can't take as big a cut as they're [the Bush Administration are] talking about." Defense funding in the budget is described as not a statement on policy but rather a placeholder until the Department of Defense completes a review of its needs. The budget protects some non-defense programs from cuts, and increases a select few others, but thereby requires a 6.2 percent cut to the remaining domestic programs for 2002 alone.

The Senate Budget Committee Chairman is right. These cuts are too large, and they will not be enacted. The budget assumes these cuts to make room for the Bush Administration's first priority: tax cuts. Even defense funding is secondary to this priority. However, if Congress approves the tax cuts but does not make these non-defense cuts, Congress jeopardizes the Social Security and Medicare surpluses.